National Grain and Feed Association

Testimony

Before the

House Committee on Agriculture

"Review of Federal Farm Policy"

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On behalf of

The National Grain and Feed Association

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Chairman Goodlatte, Ranking Member Peterson and members of the committee, thank you for the opportunity to appear before you today.

I am Mike Malecha, Senior Vice President for US Bioenergy Corporation based in Inver Grove, Minnesota. I have 30 years of experience in the food, feed and industrial agriculture industry. US BioEnergy is a producer and marketer of ethanol and distillers grains. The company currently operates one ethanol plant, which is in the process of expansion, and has three additional ethanol plants under construction. Upon completion of these initiatives, the company will own and operate four plants with combined expected ethanol production capacity of 300 million gallons per year. I am testifying today on behalf of the National Grain and Feed Association, on whose Board of Directors I serve. The NGFA has a long history of leadership and involvement in agricultural policy issues, a testament to the importance these issues play in U.S. agricultural competitiveness and our industry's ability to serve domestic and world markets.

The NGFA is comprised of 900 grain, feed, processing, exporting and other grain-related companies that operate about 6,000 facilities that handle more than 70 percent of all U.S. grains and oilseeds. The NGFA's membership encompasses all sectors of the industry, including country, terminal and export elevators; feed manufacturers; cash grain and feed merchants; end users of grain and grain products, including processors, flour millers, and livestock and poultry integrators; commodity futures brokers and commission merchants; biodiesel and ethanol manufacturers and allied industries. The NGFA also consists of 35 affiliated state and regional grain and feed associations, as well as two international affiliated associations. The NGFA has strategic alliances with the Pet Food Institute and the Grain Elevator and Processing Society, and has a joint operating and services agreement with the North American Export Grain Association (NAEGA).

The NGFA's market philosophy is derived from its Mission Statement, which commits our organization to: *"foster an efficient free market environment that achieves an abundant, safe, and high-quality food supply for domestic and world consumers*. Further, our Statement of Purpose notes that "association activities are focused on the *growth and economic performance* of U.S. agriculture." Bottom line: The NGFA advocates policies that maximize growth opportunities for U.S. agriculture.

To this end, the NGFA has identified four major priority areas that we believe need to be addressed in the next farm bill:

- Biofuels: Understanding how big and how fast this market will grow, and to craft policies that foster production to meet this demand without sacrificing other markets, including livestock and poultry feed and grain export markets;

- Conservation: Adjusting the Conservation Reserve Program (CRP) to provide opportunities for U.S. agricultural growth while enhancing protection of environmentally sensitive lands;

- Market Distortions: Developing programs that provide opportunities to take advantage of market potential and minimize further trade disruption brought about by litigation under the World Trade Organization (WTO); and

- Grain Reserves: Minimizing government involvement in grain stocks-holding, except for humanitarian purposes.

The Biofuels Impacts on U.S. and Global Agricultural Markets

By far the single most important development that will affect supply-demand balance sheets, commodity prices and the pattern of growth in various U.S. agricultural sectors in the next five years will be the developmental rate of the biofuel industries.

For the NGFA, biofuels are not a food versus fuel issue. In fact, we count among our membership the largest ethanol producer, the largest biodiesel producer, the largest commercial feed manufacturer, the largest exporter and one of the largest poultry integrators in the United States. Each may have a different focus. But they share one important priority: ensuring optimal market conditions that allow for a sufficient supply of grains and oilseeds to meet demand. For the NGFA and its member companies, the biofuels issue is a resource-capacity issue, particularly with respect to land and transportation.

No one can predict with precise certainty how quickly the biofuels industry will grow or how large it may become. But here is what we are observing: *ethanol prices are retreating from summertime highs, but corn-based ethanol production remains highly profitable and will remain so under a wide range of potential future corn- and ethanol-price scenarios.*

Forecasts regarding the ethanol industry's likely expansion rate in coming years range from USDA's most recent estimate of 10 billion gallons of capacity achieved by 2012 to some private estimates that forecast production will exceed 10 billion gallons in less than three years. Coincidently, in testimony presented Sept. 6 before the U.S. Senate Committee on Environment and Public Works, USDA Chief Economist Keith Collins noted USDA will release a new analysis of biofuel demand for corn and soybeans "this winter" and stated that USDA's February estimates "while...comforting, are out of date, as ethanol production appears to be on a path to exceed USDA's long-term projections released last winter." Collins stated that "with expected market incentives, ethanol production may reach 7.5 billion gallons over the next couple of years and could reach in excess of 10 billion gallons by 2010/11."

Estimates suggest that 35 percent or more of the corn crop could be utilized for ethanol during the life of the next five-year farm bill. While the range of ethanol-production forecasts indicates a degree of uncertainty, the most important take-away is how rapidly assumptions are changing about its potential growth. Indeed, some private estimates of ethanol production expansion have increased by as much as 50 percent in just the last six months. Driving this are the public and private forecasts of relatively firm energy prices in the face of continuing uncertainty in the Middle East and, importantly, the entry into the U.S. market over the last year of several new ethanol plant development and construction firms from Europe and from other industries. Today, provided projected ethanol returns remain reasonably healthy, the market has the capacity and the financial backing to add roughly 2 billion gallons of ethanol capacity every year, representing more than 700 million bushels of new corn demand each and every year.

The potential for significant increases in biodiesel production also will contribute to potentially dramatic changes in the grain, feed and processing industry. Some private industry estimates are that at current capacity-plus-investment trends, soy oil use for industrial purposes could increase from 82 million gallons in 2005-06 to 685 million gallons in 2010-11.

Because returns for corn-based ethanol plants likely will remain profitable over wide ranges of commodity prices, it is reasonable to project that not only will a substantially higher proportion of the corn crop be directed to ethanol during the life of the next farm bill, but that the ethanol industry could very well be in a position to bid bushels away from other uses. To avoid supply disruptions to other users of corn, the market needs to have the opportunity to bid more acres into corn production. Recognizing there will be some annual improvement in yields, there are only two substantial ways to accomplish that: 1) pull acres now used for other crops into corn production; or 2) implement policies flexible enough to permit the market to bid for productive, non-environmentally sensitive acres expiring from the CRP.

Make no mistake, if current biofuel investment trends continue, the United States will experience lower average stocks for grain and comparatively higher prices for corn and for other grains as crops compete for available resources. This scenario could develop very quickly. Grain futures markets already reflect such expectations. Over the life of the next farm bill, it is entirely conceivable that the United States will require an additional 8 million to 10 million planted acres of corn to avoid triggering: 1) sharp declines in livestock profitability; 2) supply interruptions to long-term export markets; and 3) supply shortages that could hamper ethanol profitability.

In his Sept. 6 statement, Dr. Collins also noted that key factors that could help manage risk from ethanol growth are corn yield increases and acreage withdrawals from the CRP. Concerning the CRP, he stated that USDA analyzed all CRP land enrolled during general signups in counties where 25 percent or more of harvested cropland was producing non-irrigated corn and soybeans. Looking at only those CRP acres in this category, Collins stated that 4.3 million to 7.2 million CRP acres could be used to grow corn or soybeans "in a sustainable way."

The National Grain and Feed Foundation (NGFF) is in the process of commissioning an independent study to assess scenarios for the "most likely outcome" for biofuel production each year -- including the lowest and greatest growth rates that can reasonably be expected, given both incentives and practical constraints on adding biofuel capacity. In addition, the NGFF has asked researchers to focus on two factors we believe could have the greatest potential to limit future growth in both traditional U.S. agricultural markets and in the biofuels market: 1) land-use restrictions imposed by government, the most significant of which is the CRP; and 2) limitations on the United States' near-term ability to expand transportation capacity and services adequately, particularly rail freight.

The NGFA supports the development of public policy that facilitates opportunities for growth in grain and oilseed production to supply traditional (feed, export and grain processing) and new (ethanol and biodiesel) market demand. Achieving this objective will be a significant challenge for the industry, Congress and the administration as a new farm bill is written.

Conservation Impacts on Land Use and U.S. Competitiveness

As noted previously, adjusting the CRP is one significant potential solution to anticipated land-capacity constraints. Acres currently enrolled in the CRP represent the fourth largest crop in the United States. And if current trends continue, CRP will surpass acres planted to wheat.

The NGFA recognizes the importance of conservation measures; but we encourage an approach that reflects a commitment to free enterprise and support for U.S. agricultural growth. As such, the NGFA supports conservation programs that foster sound farmland conservation and environmental-stewardship practices, while minimizing idling of productive land resources, thereby strengthening the economies of rural communities while achieving environmental and other policy goals.

We submit that the CRP should be balanced, productive and not work at cross-purposes to a healthy commercial U.S. agriculture sector. Congress can assist by enacting a conservation policy worthy of continued taxpayer support that does not undermine U.S. agriculture's competitiveness by idling productive land assets.

What policies should be considered to accomplish this objective?

As Congress is aware, the U.S. Department of Agriculture (USDA) developed and implemented a plan to reenroll or extend many of the acres under CRP contracts that are set to expire between 2006 and 2010. While the NGFA does not support automatic CRP reenrollments or extensions, we understood the need to ease potential market impacts of so many acres expiring in such a short time frame. In our view, the large numbers of acres reenrolled or extended is unfortunate. But USDA's plan does provide the flexibility for Congress to redesign the CRP over the life of the next farm bill.

Under USDA's plan, all acres enrolled in expiring 2006-10 CRP contracts are to be evaluated based upon their Environmental Benefits Index (EBI) percentile scores in effect at the time the acres originally were enrolled in the program. The percentile scores then are grouped into one of five EBI tiers. Acres with an EBI ranking in the 80 to 100 percentile range are eligible for enrollment under new 10-year contracts (15 years for acres with wetlands). Remaining expiring CRP contract acres are eligible for extensions ranging from two to five years at their previous CRP rental rates, based upon their EBI rankings.

The NGFA supports USDA's utilization of the EBI to determine which lands are most environmentally sensitive and should be idled. However, we remain concerned that contracts extended two to five years then will be offered reenrollments in the future, which could lock up these productive land resources for an additional 10 to 15 years. Thus, we encourage USDA to allow current CRP contract extensions to expire once the extension date is reached. This would accomplish the intended effect of minimizing distortions of mass CRP contract expirations in any one year, while allowing U.S. agriculture the flexibility to bid these acres back into production to meet demand as biofuels production continues to expand at a significant pace. Further, the NGFA believes future enrollments of previous or new CRP contract acres should be based upon updated EBI scores and current rental rates, and USDA should enroll only those acres that are most environmentally beneficial. We recognize that environmental benefits are limited when acres are not enrolled under long-term CRP contracts; that's precisely why we believe only those acres within the top range of EBI scores should be idled.

While the NGFA still is evaluating other specific policy recommendations for the CRP to be addressed in the next farm bill, we believe several options merit consideration. These include: 1) reducing the current statutory cap on CRP enrollments; 2) placing a statutory limit on the annual authorized funding level; and/or 3) altering how rental rates are established to ensure that government does not overly subsidize land-idling programs to the detriment of economically viable land-use options. Government bidding for productive CRP acres in competition with the private sector hampers efficiency and dampens U.S. agricultural growth. Regardless of the method, it is critical for the long-term viability of the U.S. grain and oilseed industry to provide sufficient flexibility to bring idled cropland back into production and limit idling of productive land when market conditions warrant.

Another important consideration for Congress when adjusting the CRP is to ensure that any acres that exit the program are on an even footing with other base acres with respect to farm program payment eligibility. Unless such equity is achieved, there will be a significant economic disincentive to restore non-environmentally sensitive CRP acres to production.

The NGFA believes that refinements to the CRP will be essential to obtain the increased number of corn and soybean acres likely to be needed to support a growing biofuels industry while maintaining the demand for corn from export and livestock and poultry markets. Idling productive farmland runs counter to the support Congress and the administration have shown to biofuels and creating opportunities for growth.

Other Negative Impacts of the CRP

The negative impacts of the CRP extend beyond concerns over having sufficient grain and oilseed supplies to meet market demand.

The NGFA regularly hears from members whose businesses and rural communities have been devastated by excessive idling of large tracts of productive farmland under the CRP. The economic damage is very real. From Idaho, the local co-op manager in Moscow, as he was resigning from the NGFA for financial reasons, stated, "the CRP program is a major reason for the downfall of our company. Over 45,000 acres in our service area are now in CRP." From the state of Washington, the elevator manager from Lind, in Adams County, reports that about one-third of the acres in his marketing area are out of production, much of it in CRP, while the population has dropped nearly 30 percent and school enrollment has declined nearly 40 percent. Lind, WA, has lost two farm equipment dealerships, a bank, an insurance broker and a hardware store. In a neighboring town in the same county, the school has half the enrollment it had a dozen years ago.

The CRP program's main financial benefits flow to landowners. What is sometimes forgotten is that the unintended side effects probably do the most economic damage to the producers that many policymakers would most like to help – beginning farmers and tenant farmers trying to earn a reasonable income from active farming. CRP rental rates inflate land values, which reduce the profitability of tenant farming. Reducing available farm rental acreage also makes it more difficult for beginning and tenant farmers to put together an efficiently sized production unit that will provide for a reasonable income. USDA's own Beginning Farmer and Rancher Advisory Committee has recommended that the secretary of agriculture "direct ERS, FSA and NRCS to research policy options for the CRP program to enhance beginning farmer and rancher opportunities as the next big wave of CRP contract expirations begin in FY 2006-2008." This recommendation was made in March 2004, but we have yet to see any USDA statements that this proposal is under active consideration.

Another concern for the NGFA involves the validity of the current 25-percent county cap on CRP enrollments. It appears that because USDA is using outdated cropland data to determine the per-county cap acreage, total acreage being enrolled far exceeds 25 percent of a modern-day "normal cultivated acreage" (in the absence of a CRP program) for a given county. A couple of examples are illustrative: 1) Harmon County, OK, has 51,000 acres enrolled in the CRP, but only harvests 84,000 acres of cropland; 2) Ellis County, OK, has 63,000 acres in the CRP with current plantings of crops of 97,000 acres. Both of these examples suggest the 25 percent cap, as being administered by USDA, has not successfully limited the potential economic damage to rural areas. In addition, as noted previously, because so many counties already have reached or exceeded the 25 percent limit as now being administered, USDA is being prevented from enrolling valuable filter strips in such counties that could contribute meaningfully to water-quality objectives. The NGFA recommends that Congress take a renewed look at the 25 percent cap and make adjustments to ensure its usefulness in reducing the potential negative impacts of the CRP, while maintaining flexibility to enroll the most appropriate acres.

The wheat industry has been affected most adversely by the CRP, particularly the buyout of whole, productive farms. A majority of the CRP ground has been concentrated in wheat states. The large number of acres in the CRP in the Northern Plains has adversely affected U.S. agriculture's ability to produce adequate quantities of oats and certain classes of wheat, and imports have become critical. Predictably, U.S. wheat imports have accelerated and the United States has struggled to grow enough for our domestic mills. In addition, as ethanol production increases, corn acres will move west, further pressuring the competitive position of U.S. wheat. The NGFA continues to oppose the enrollment, reenrollment or extension of whole farms or large tracts of productive land into the CRP.

The NGFA is not alone in expressing concerns about CRP. Fourteen agricultural trade associations representing agricultural businesses, suppliers and end users endorsed testimony presented last year by NGFA President Kendell Keith before the Senate Agriculture Committee on the CRP. More recently, the Iowa Farm Bureau Federation announced its support for eliminating the CRP. Commenting on the proposal, Iowa Farm Bureau President Craig Lang stated, "I think it was the loss of community activity and economic viability, and our farmers today said we want to send a message." The National Association of Wheat Growers, in a joint paper with the North American Millers' Association, indicated "idling productive resources raises production costs and has a detrimental impact on competitiveness." The American Soybean Association has said it "supports restricting the CRP to environmentally sensitive lands, and returning productive farmland currently enrolled in the CRP to production." The message from a wide range of U.S. agriculture is clear: American agriculture is poised to take advantage of significant growth opportunities and U.S. government programs should facilitate, not hinder, its ability to compete.

The United States currently idles 36.7 million acres in the CRP, roughly 15 percent of available farmland. Congress has capped the CRP at 39.2 million acres. But enrolling still more acres in the CRP will hamper U.S. agriculture's ability to: 1) produce and compete in domestic and global markets; 2) provide opportunities to young farmers and ranchers and tenant farmers to enter production agriculture; 3) sustain economic growth in the domestic livestock and poultry sectors; and 4) minimize the negative impacts of the CRP on local rural economies. The size of the CRP has a direct impact on the availability of land to build and grow an economic foundation for agricultural producers, grain handlers, processors, exporters and other U.S. agribusiness sectors. The 2002 farm bill contained unprecedented authorizations for conservation spending, particularly for working lands programs such as the Environmental Quality Incentives Program (EQIP) and Conservation Security Program (CSP). The NGFA strongly supports directing scarce conservation resources to programs like these that enhance conservation of working farmlands, coupled with a shift away from land-idling schemes.

Minimizing Market Distortion in Farm Programs

The NGFA also wishes to reiterate its long-standing position that Congress and farm organizations are in the best position to determine the appropriate level of federal funding to allocate to farm program payments. However, the NGFA does have three specific concerns relative to farm program payments. First, such payments should minimize market-distorting signals. Second, we believe Congress should avoid major and immediate shifts in funding levels and program implementation that create near-term disruptions. And third, we support the statements from the leadership of this committee that U.S. farm program payments should be structured and implemented in a way that minimize exposure to World Trade Organization (WTO) challenges.

Minimizing market-distorting farm income supports contributes stability and predictability to the market. This stability gives the industry greater flexibility to pursue new opportunities for U.S. agricultural growth while improving U.S. competitiveness. The NGFA recognizes the need for government to support agricultural producers given the volatility associated with agricultural production and supports programs that meet this goal while minimizing market distortions.

The NGFA also supports limiting dramatic swings in farm program funding levels and delivery that create short-term disruptions. A measured and incremental approach to implementation is preferred to give markets the opportunity to efficiently adjust to new programs and funding levels.

Finally, we remain concerned over U.S. agriculture's exposure to further litigation within the WTO. The NGFA strongly supports the administration's efforts to complete a comprehensive trade agreement under the WTO's Doha Round. Doing so would provide significant new market access for U.S. agricultural products, dramatically reduce trade-distorting domestic supports (particularly those in Europe, Japan and other countries) and eliminate export subsidies. The current "freeze" in negotiations is unfortunate, and we recognize the uncertainty of completing a comprehensive global trade agreement within a reasonable time frame. We believe the 2007 farm bill is the right place to enact policy reforms that will bring U.S. farm programs into compliance with our WTO commitments. Absent changes, U.S. production and trade conditions will operate under a cloud of potential challenge. Moreover, any successful challenge could impart sudden changes in the U.S. agricultural system.

The Folly of Government-Controlled Reserves

Finally, given the potential demand pulls and market opportunities noted previously, the idea of resurrecting a government-controlled grain reserve is a worse idea today than it was when it failed in the 1980s.

Government-subsidized stocks holding has proven to be bad policy for a number of reasons. First, government-controlled stocks distort market price signals and can adversely affect planting and marketing decisions. Second, such programs encourage uneconomically justified storage expansion decisions by the private sector. Third, they blur market signals – known as carrying charges – that provide incentives for producers and the industry to store grain. Fourth, they can – and have – undermined price rallies for producers created by market demand because those reserve stocks overhang the market. Finally, the government has shown in the past that once stored in a reserve, it is difficult to ever release such stocks even if price triggers are in place.

The NGFA also opposes government-subsidized programs that are designed to expand commercial or on-farm grain storage capacity. The market has – and will – provide the necessary economic incentives to encourage construction of storage where and when it is warranted.

The NGFA does recognize, and support, the need for government controlled reserves intended for humanitarian purposes, such as the Bill Emerson Humanitarian Trust.

General Recommendations for the 2007 Farm Bill

In closing, the NGFA offers the following general recommendations for consideration by Congress in developing the 2007 farm bill.

1) Provide access to sufficient acres to meet demand growth from energy and biofuels without shorting supplies necessary to grow other important demand sectors, such as export and domestic livestock and poultry markets.
2) Authorize conservation programs that minimize reliance on idling of productive land resources and strengthen the economies of rural communities, while achieving environmental and other policy goals.

3) Limit acres idled under the CRP. The CRP should shift away from the enrollment of whole farms and should focus on the most environmentally sensitive acres and on filter strips and other areas that do the most to enhance water quality.
4) Provide flexibility for acres to leave the CRP and ensure once acres exit or expire that they are fully eligible for farm program benefits as established by the next farm bill.
5) Craft farm program payments that minimize market distortions and volatile swings in funding availability.
6) Devise farm income supports in a way that minimize risk for potential challenges in the World Trade Organization (WTO).
7) Reject proposals to establish government- controlled or managed grain reserves or government-subsidized storage programs.

Conclusion

The NGFA appreciates this opportunity to provide an outline of its major concerns, as well as some general recommendations, for the next farm bill. We intend to provide more specific recommendations as soon as the study to be conducted by the National Grain and Feed Foundation is completed and our industry representatives have time to analyze and discuss its findings.

These clearly are issues that have significant impacts on NGFA members and our farmer-customers. In closing, I would leave you again with a line from the NGFA Statement of Purpose: The association is "focused on the growth and economic performance of U.S. agriculture." We are hopeful that as Congress considers the next farm bill that it also will focus on the "growth and economic performance" for all of U.S. agriculture.

Thank you, and I look forward to answering any questions you may have.

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2004.

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1. **Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2004, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:**

Source: None **Amount:** ________

Source: ________ **Amount:** ________

2. **If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2004, as well as the source and the amount of each grant or contract:**

Source: None **Amount:** ________

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